92D CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
1st Session } { No. 92–543

CREDIT UNION SHARE INSURANCE AMENDMENTS

OCTOBER 1, 1971.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. PATMAN, from the Committee on Banking and Currency, submitted the following

REPORT

[To accompany H.R. 9961]

The Committee on Banking and Currency, to whom was referred the bill (H.R. 9961) to provide temporary insurance for the member accounts of certain Federal credit unions, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the matter that appears in italic type in the reported bill.

HISTORY OF THE LEGISLATION

H.R. 9961 was introduced on July 21, 1971, by Chairman Patman. On September 22, the Bank Supervision and Insurance Subcommittee, under the chairmanship of Congressman St Germain, held hearings on the legislation. Testifying at that time were: General Herman Nickerson, Administrator of the National Credit Union Administration; Mr. R. C. Robertson, past president, Credit Union National Association; Mr. Robert Bianchini, managing director, Rhode Island Credit Union League and former superintendent of banking of the State of Rhode Island; Mr. Mack Rogers, president, National Association of Federal Credit Unions; and Miss Shirley Grasty, managing director, American Federation of Community Credit Unions. The following day, the subcommittee met in executive session and recommended the legislation to the full Committee with amendments. On September 29, the full Committee met in executive session and the Committee ordered the bill with further amendments favoraby reported.

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Need for the Legislation

Under Public Law 91–468, signed October 19, 1970, a program of mandatory share insurance for Federal credit unions was established within the National Credit Union Administration. Included in the law was a provision for insuring State chartered credit unions, although not on a mandatory basis. Under the law, Federal credit unions were required to file applications with the National Credit Union Administration for the insurance. If the application was rejected because the credit union failed to comply with the standards outlined in the law, then the credit union had 1 year to correct the deficiencies and obtain the insurance or be forced into liquidation.

At the present time, there are some 1,400 Federal credit unions whose insurance applications have been rejected. Unless they can obtain the insurance, the liquidations of these credit unions will begin in January, 1972.

The lack of insurance for these credit unions severely handicaps their ability to attract share deposits, and the lack of income seriously handicaps their ability to remedy their deficiencies. For instance, under Public Law 91–468, credit unions serving predominantly low income areas may accept deposits from persons or organizations outside of their field of membership. This was done so that corporations or individuals wishing to help these credit unions would not only be able to make share deposits but would also have these deposits insured. However, your Committee notes that some 106 of these low income area credit unions have not been able to obtain insurance and without the insurance they are unable to attract outside share capital. Without this outside share capital, there is little possibility that they will be able to correct their problems as determined by the Administrator and obtain share insurance.

This legislation would also correct a situation concerning State chartered credit unions in Rhode Island. Last year Rhode Island became the first State in the nation to enact a law that would permit State chartered credit unions which met certain requirements to accept demand deposits. When the Rhode Island credit unions applied for insurance they were informed by the National Credit Union Administration that that agency did not feel it had the authority under existing statutes to insure the demand deposits. Subsequently, Rhode Island changed its law to provide that credit unions in order to offer demand deposits were not required to obtain Federal insurance for this class of deposits. Armed with the new State law, Rhode Island credit unions once again applied for insurance but were again rejected by the National Credit Union Administration on the grounds that in the event of a liquidation, the demand deposit holders would have a priority claim on the assets of the credit unions ahead of the insured share holders. Thus, no State credit union in Rhode Island accepting demand deposits has been able to obtain Federal insurance on its share deposits.

This legislation would correct the situation so that Rhode Island State chartered credit unions may receive insurance on their share accounts, and provided that the demand deposit accounts are subordinate to share accounts in the event of a liquidation. No insurance would be permitted on demand deposits.

Your committee wishes to make it clear that this section in no way provides demand deposit authority for Federal credit unions, nor does it encourage or discourage the offering of such services by State chartered credit unions.

Finally, the legislation gives the Administrator more latitude in providing guarantees and other assistance to financially troubled credit unions in the event of mergers, consolidations or stabilization practices.

General Comments

While a great deal of discussion on H.R. 9961 centered around the monetary facts of insuring the 1,400 credit unions that have been rejected, your Committee at the same time is vitally concerned about the impact of the lack of insurance upon the members of these credit unions.

If the credit unions fail to obtain insurance and must liquidate, it will mean that thousands of credit union members will not only be without credit union service, but because of the common bond concept under which credit unions operate, these people will for the most part be unable to join another credit union. This will mean that many of these individuals will lose a vital opportunity to better themselves economically. While your Committee wishes to make it clear that by virtue of this legislation it is not ordering nor condoning the insuring of credit unions whose operations may be in violation of the requirements set by the Administrator at the same time it expects the Administrator to insure those credit unions whose operations, including their reserve requirement policies, meet the standards set out by Congress. To this end, the Committee feels that the Administrator has denied insurance coverage based on failure of the credit unions to meet regulations promulgated by the Administration rather than for failure to meet the standards outlined in the law.

Approximately 80 percent of the credit unions who have been rejected for share insurance have been so because of a failure to meet reserve requirements set by the Administrator and not by Congress. In enacting Public Law 91–468, the Congress at the urging of the National Credit Union Administration established new reserve requirements for Federal credit unions. Your Committee feels that these reserve requirements spelled out in Section 116(a) of the Federal Credit Union Act are adequate for purposes of obtaining insurance. In too many cases, the National Credit Union Administration has required credit unions to meet special reserve requirements in order to obtain insurance. Thus, we are faced with the paradox of a Federal credit union meeting the reserve requirements set down by Congress but being denied insurance because it does not meet the reserve requirements established on an administrative basis.

In its report on the legislation which eventually became Public Law 91–468 (Federal share insurance legislation) your Committee recognized the need for special reserves. However, your Committee thought it had made it clear in its report that the special reserves were to be used only on a selective basis rather than on a broad brush approach. In that report, the Committee wrote, "Further, it is the Committee intent that the Administrator is charged with judicious application of his authority to impose special reserve requirements to in-

clude, but not limited to, considerations of the nature of the credit union's operation. * * * The historical as well as current delinquency rate should be evaluated prior to the imposition of special reserve requirements." Your Committee feels that the special reserve requirements has been invoked in too many cases to deny insurance and suggests that if the National Credit Union Administration feels that the legal reserve requirements as set forth in Public Law 91–468 are not adequate to safeguard the share insurance fund then it should submit legislation to the Congress with appropriate recommendations. For this reason, the Committee has withdrawn the special reserve requirement provision as a condition of obtaining insurance.

Your Committee is also concerned that some credit unions are being denied insurance for reasons that have no basis within the Federal Credit Union Act. As an example, your Committee has learned of a Federal credit union in the Northeast which serves the employees of a manufacturing concern. The credit union has only 42 members but has reached approximately 90 percent of its potential membership. It has assets of $7,000 and loans of approximately $5,000. Not a single loan is delinquent and in fact since the credit union was started four years ago, it has charged off against reserves only $4.57. The management of the credit union is composed of volunteers. According to the State credit union league, this credit union is one of the best run in the state. Quite clearly the credit union is in no way in violation of either the spirit or the intent of the Federal Credit Union Act. In fact, it may well be a model of what the original credit union act had in mind. The shocking part is that this credit union has been denied share insurance because "it does not have qualified management." Your Committee is deeply concerned that there are other credit unions in similar situations who are being denied insurance not because they are in violation of the law but rather they do not fit preconceived notions of what a credit union should be set down by the National Credit Union Administration. Your Committee hopes that this credit union was not denied insurance solely because it was too small or that there is any thought on the part of the National Credit Union Administration of establishing a size criteria that would subvert the intent of the original drafters of the Federal Credit Union Act.

Your Committee is fully aware that there may be credit unions whose operations do not meet the standards set by the Administrator. While such violations cannot be condoned, your Committee feels that the withholding of insurance for these reasons works an extreme hardship on the members of such credit unions. Your Committee further feels that it is possible to insure these credit unions and at the same time correct the abuses within the two years as provided in H.R. 9961. Under Public Law 91–468, the National Credit Union Administration at its urging was granted cease and desist powers to correct a wide range of violations of the law. Prior to the granting of such powers, the only remedy the Administration had was to revoke the charter of the credit union. It argued for the cease and desist powers on the grounds that it needed a middle ground penalty since it felt that revocation of the charter was too severe for some of the violations. Your Committee acceptedd that argument and granted the cease and

desist powers. The Committee feels that the Administration should use the cease and desist authority to correct the problems for which it is now withholding insurance. Failure to do this negates the very reasons for which the Administration argued for the authority, namely, that it needs a middle ground penalty rather than revoking a charter, which is exactly what will occur if the credit union cannot obtain insurance.

Thus, if the Administration will provide the insurance authorized under this bill, it can correct all of the problems which it described to the Committee in its testimony and at the same time safeguard the deposits of the credit union members without endangering the fund.

In passing, your Committee notes that on only one occasion has the National Credit Union Administration used the cease and desist authority.

No Danger to Insurance Fund

It has been contended by some that insuring these 1,400 credit unions would cause an undue risk to the insurance fund. Your Committee does not feel that any proof has been brought forth to substantiate this argument. In his testimony before the Committee, General Nickerson, Administrator of the National Credit Union Administration, pointed out that 50 percent of the rejected credit unions could qualify for insurance within one year, and he added that all but 365 credit unions would qualify if the period were extended past one year. By his very statement, it would appear that there is no danger of liquidation and a drain on the fund except for 365 credit unions since this bill would provide the credit unions with two years of insurance, an adequate period with which to stabilize credit unions.

It cannot be assumed that the remaining 365 credit unions, most of which may not be able to qualify for insurance under H.R. 9961, would all go into liquidation. But if they did, it must be pointed out that these credit unions do have assets which would limit the amount of money that would be lost to the Fund. Also, it should be pointed out that this is not free insurance being provided to the credit unions but rather that they will pay the standard premium of 1/12 of 1 percent of shares per year for the insurance.

Nor can the safety record of credit unions be overlooked. Since the Federal Credit Union Act was passed in 1934, these institutions have had losses of less than 1/10 of 1 percent of their total shares. Based on this outstanding record of safety, there is no reason to suspect that there will be any significant drain on the Fund. In addition, your Committee recalls that when the share insurance legislation was originally introduced in the House, a premium of 1/20 of 1 percent was established. However, this figure was subsequently increased to 1/12 of 1 percent at the suggestion of the National Credit Union Administration because the original bill called for the insurance of all credit unions and it was argued that a higher premium was necessary in order to meet the so-called "blanketing-in" provisions. However, when these provisions were taken out of the bill, the premium was not reduced. This means that there is extra money in the Share Insurance Fund for insuring all credit unions. When the National Credit Union

Administration testified on the original bill, it estimated that during 1970 some $452,000 would be lost in credit union liquidations. With most of 1971 having passed, it is interesting to note that not a single penney has been lost to the Fund. While the Committee does not wish to suggest that the Fund should have met the loss estimate, it merely raises this point to show that the Fund was set up at such a level to anticipate reasonable loss and, therefore, the Fund can well handle the provisions of this legislation.

Finally, as an example of what might be anticipated under this insurance program, your Committee wishes to point out that the State of Wisconsin operates a share insurance fund for State chartered credit unions. When that program began in 1970, all credit unions were automatically insured regardless of their financial condition. Despite this exposure, the fund rather than sustaining huge losses has grown. In 1970, the Wisconsin Share Insurance Corporation had a surplus of income over expenses of more than $23,000 and for 1971 there is an anticipated surplus of some $123,000.

When the House debated the original share insurance bill, the Chairman of the Committee on Banking and Currency, the Honorable Wright Patman, said that credit unions have established a remarkable record of safety and this bill is a reward for that achievement. The record of safety was achieved by all credit unions, and the reward of share insurance was intended to be shared equally by all credit unions.

Section-by-Section Analysis

Section 1

This section provides that any Federal credit union whose application for insurance has been denied, the Administrator of the National Credit Union Administration shall provide insurance for a two year period provided that the credit union meets the reserve requirements of Section 116(a) of the Federal Credit Union Act, and is not in violation of any provision of the Federal Credit Union Act. The reserve requirements set down in Section 116(a) provide as follows:

> Immediately before the payment of each dividend, the gross earnings of the credit union shall be determined. From this amount, there shall be set aside, as a regular reserve against losses on loans and against such other losses as may be specified in regulations prescribed under this Act, sums in accordance with the following schedule:
>
> 10 per centum of gross income until the regular reserve shall equal 7½ per centum of the total of outstanding loans and risk assets, then
>
> 5 per centum of gross income until the regular reserve shall equal 10 per centum of the total of outstanding loans and risk assets.
>
> Whenever the regular reserve falls below 10 per centum or 7½ per centum of the total of outstanding loans and risk assets, as the case may be, it shall be replenished by regular contributions in such amounts as may be needed to maintain the reserve goals of 7½ per centum or 10 per centum.

During the two year period of inurance, a Federal credit union would be required to obtain permanent insurance subject to all the criteria set out in the Federal Credit Union Act and if it failed to meet these qualifications once the two year period had expired, it would revert to an uninsured status and face liquidation.

Section 2

This section provides that in states which allow state credit unions to accept demand deposits, the credit union if it otherwise is qualified for Federal share insurance may not be denied this insurance solely because it accepts demand deposits. The section further provides that the demand deposits shall not be covered by the Federal share insurance and shares will be covered by the insurance only if the demand depositors are subordinated to shareholders in the event of a liquidation of the credit union.

Section 3

Under the Federal Credit Union Act, the Administrator, in order to prevent potential cash flow problems to the insurance fund, is authorized to guarantee any insured credit union against loss by reason of its assuming the liabilities and purchasing the assets of an open or closed insured credit union. The same situation occurs with respect to a merger or consolidation of an insured credit union with another insured credit union. This section provides the Administrator with more latitude in carrying out this section of the Federal Credit Union Act. It provides that the Administrator is not limited in his guarantee authority to an insured credit union. Instead, at his discretion he may guarantee or allow the assumption of a liability by any credit union, individual, partnership, corporation, trust, estate, cooperative, association, government or government subdivision or agency or other entity. Thus, liquidating credit unions serving employees of a manufacturing concern might make arrangements with the manufacturing concern to assume its liabilities and purchase its assets with a guarantee provided by the National Credit Union Administration. Since this might be the only "entity" that would be interested in such an arrangement, this section would legalize such a transaction.

Cost of Carrying Out the Bill and Committee Vote

In compliance with Clause 7 of Rule XIII of the Rules of the House of Representatives, no additional funds are needed in order to carry out the provisions of this bill.

In compliance with Clause 27 of Rule XI of the Rules of the House of Representatives the following statement is made relative to the reporting vote on the bill, a total of 27 votes were cast for reporting and a total of 4 votes were cast against reporting the bill.

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is

enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman) :

FEDERAL CREDIT UNION ACT

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TITLE II—SHARE INSURANCE

INSURANCE OF MEMBER ACCOUNTS AND ELIGIBILITY PROVISIONS

SEC. 201. (a) * * *

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(c) (1) Before approving the application of any credit union for insurance of its member accounts, the Administrator shall consider—

(A) the history, financial condition, and management policies of the applicant;

(B) the economic advisability of insuring the applicant without undue risk of the fund;

(C) the general character and fitness of the applicant's management;

(D) the convenience and needs of the members to be served by the applicant; and

(E) whether the applicant is a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.

(2) The Administrator shall [reject] *disapprove* the application of any credit union for insurance of its member accounts if he finds that its reserves are inadequate, that its financial condition and policies are unsafe or unsound, that its management is unfit, that insurance of its member accounts would otherwise involve undue risk to the fund, or that its powers and purposes are inconsistent with the promotion of thrift among its members and the creation of a source of credit for provident or productive purposes.

(3) With respect to State credit unions which are authorized by State law to receive demand deposits, the Administrator shall approve the application of any such State credit union for insurance of its member accounts if (A) such State credit union otherwise meets the requirements for insurance established under this Act, and (B) in the event of liquidation of such State credit union, the claims with respect to demand deposit accounts shall be subordinate to the claims with respect to member accounts. For purposes of this paragraph and for purposes of determining the extent of insurance coverage under this Act, demand deposit accounts shall not be considered member accounts and shall not be insured under the provisions of this Act.

[(d) If the application of a Federal credit union for insurance is rejected, the Administrator shall suspend or revoke its charter unless, within one year after the rejection, the credit union meets the requirements for insurance and becomes an insured credit union.]

(d) In the case of any Federal credit union whose application for insurance is disapproved, if such Federal credit union (1) has transferred such amounts to its reserves as is required under section 116(a),

and (2) has not violated any provisions of this Act, the Administrator shall nonetheless issue to such Federal credit union a certificate of insurance which shall be valid for a period of two years. The Administrator shall suspend or revoke the charter of any Federal credit union which has failed, upon the expiration of such two-year period of insurance, to file an application for insurance which is approved by the Administrator in accordance with subsection (c). A Federal credit union which is insured under this subsection for a period of two years is an insured credit union under the provisions of this title for such period of two years.

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SPECIAL ASSISTANCE TO AVOID LIQUIDATION

SEC. 208. (a) (1) In order to reopen a closed insured credit union or in order to prevent the closing of an insured credit union which the Administrator has determined is in danger of closing, the Administrator, in his discretion, is authorized to make loans to, or purchase the assets of, or establish accounts in such insured credit union upon such terms and conditions as he may prescribe. Such loans shall be made and such accounts shall be established only when, in the opinion of the Administrator, such action is necessary to protect the Fund or the interests of the members of the credit union. Such loans and accounts may be in subordination to the rights of members and creditors of the credit union.

(2) Whenever in the judgment of the Administrator such action will reduce the risk or avert a threatened loss to the fund and will facilitate a merger or consolidation of an insured credit union with another insured credit union, or will facilitate the sale of the assets of an open or closed insured credit union to and assumption of its liability by another [insured credit union] *person* the Administrator may, upon such terms and conditions as he may determine, make loans secured in whole or in part by assets of an open or closed insured credit union, which loans may be in subordination to the rights of members and creditors of such credit union, or the Administrator may purchase any of such assets or may guarantee any [other insured credit union against loss by reason of its] *person against loss by reason of his* assuming the liabilities and purchasing the assets of an open or closed insured credit union. *For purposes of this paragraph, the term "person" means any credit union, individual, partnership, corporation, trust, estate, cooperative, association, government or governmental subdivision or agency, or other entity.*

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